UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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ASSURED GUARANTY MUNICIPAL CORP.,

Plaintiff,

v. 13 CV 2019 (JGK)

RBS SECURITIES, INC., et al,

Defendants.

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New York, N.Y.
March 17, 2014
2:45 p.m.

Before:

HON. JOHN G. KOELTL,

District Judge

APPEARANCES

WOLLMUTH, MAHER & DEUTSCH
Attorneys for Plaintiff
BY: WILLIAM A. MAHER
RANDALL R. RAINER
JOHN E. LAZAR

GOODWIN PROCTER
Attorneys for Defendant
BY: BRIAN D. HAIL
DAVE FREEBURG

ALSO PRESENT:

JONATHAN PERRY - RBS Representative

(Case called)

MR. MAHER: Bill Maher, on behalf of plaintiff Assured Guaranty. With me is my partner, Randall Rainer and my colleague, John Lazar. I also have client representatives I would like to introduce you to. This is Edward Newman, Jonathan Meyers and Michael DiRende in the first and second rows.

THE COURT: All right. Thank you.

MR. HAIL: Good afternoon, your Honor. This is Brian Hail from representing the RBS defendants. With me is Dave Freeburg and my client representative, Jonathan Perry.

THE COURT: I suspect I know people Goodwin Procter. Nothing about that affects anything that I do in the case. I don't know any of the lawyers who are actually appear on either side, I don't think. I can always be wrong.

Again, nothing about that affects anything that I do in the case. This is a motion to dismiss. All it is is argument.

MR. HAIL: Good afternoon, your Honor. I am Brian Hail from Goodwin Procter representing the RBS defendants in this case.

As your Honor earlier noted, we made a motion to dismiss the complaint in its entirety. I won't attempt to retrace all the arguments, all the case law cited in the various pleadings and briefs, but let me start with basic facts

about the transaction and sequence of events and lead to why this case is unique, and how the facts interplay in some of the case law, which might not be the world's most clear case law out there right now.

This is a case involving an RMBS securitization. RBS was not the originators of these loans. They did not underwrite the loans or talk to the borrowers. It purchased the loans, packaged them together, issued them through a trust structure to a series of note holders.

Assured, then known as FSA if you see it in the some of the correspondence, provided a monoline wrap for one particular monoline of these loans. That monoline ended up representing, it's called the class 2A1 certificates and approximately $291,000,000 in principal. That tranch of notes was backed by approximately 1,500 loans as collateral. Those loans represent approximately $362,000,000 of collateral in principal amount to cover that particular tranch of loans.

In connection with this deal, the first interaction that's alleged between Assured -- I will call it Assured through the course of the discussion -- was March 1, 2007, where there apparently had been some discussion, a loan tape is sent. A loan tape is a Excel spreadsheet with loan characteristics, LTV, CLTVs, borrower information, principal amounts, location of mortgages, things like that. That's in amended complaint paragraphs 45 and 49.

After that is sent, there is something sent to Assured called the term sheet. The term sheet is actually attached to the Hail declaration that we put in with our motion as Exhibit B. According to the complaint, paragraph 49, that is sent at 8:26 p.m. on March 7. It says, Per your conversation with Mr. Skeebo, attached is the term sheet and the loan tape.

The very next morning Assured specifically asked for something called the CDI file and asked if the diligence on the deal will be made available. A CDI file is a structuring file that allows a party to look at the cash flows on the transaction. In essence, to see, how the waterfall structure of the payment of the notes works. RBS responded the next morning, saying they would send the diligence reports after a release was executed. Within four hours Assured attaches a signed release and sends it back to RBS. The next day RBS sent a series of files to Assured. That is reflected in the Hail declaration Exhibit A as that e-mail exchange.

Those files represent 8,000 pages of diligence materials. And rather than submit that to the Court at this time, we did not include it with my declaration, but as 8,000 pages of loan level material, summaries -- I have a copy of it in the courtroom if your Honor would like for whatever reason.

That diligence material is what was specifically requested, and specifically contains loan level information. That was forwarded after the release was executed as was the

CDI file. The diligence information, we will come back to it frequently in this case -- it is a unique feature in this case that distinguishes it from other cases where courts have not dismissed complaints.

The diligence material revealed one of two things. Either there were no problems in the transaction, and Assured was comfortable with it and they did the deal with knowledge of the diligence results. Or the diligence raised incredible red flags that were somehow worked through and Assured did the deal anyway. In any event, Assured received the diligence materials. We know that and they have to have formed some basis of their decision-making.

In any way, the consideration and the relevance of the disclosure in the diligence materials is relevant to the claims here and mandates the dismissal because of the release.

This case is unique for three reasons. The first is that RBS did not originate the deals. In a great deal of the RMBS cases that are cited by Assured the sponsor/originator/underwriter originates the loans. That is significant because the originator has that contact with the borrower, has that knowledge of the underlying guidelines, has knowledge of the process that's involved. That third-party basis that we are not the originator has been the distinction of several courts that have indicated that there is no special relationship, for example, duty to disclose information or

knowledge of underlying guidelines. Particularly in a case, for example, in the *Union Central* case, about the quality of the representations made.

THE COURT: Putting aside the duty to disclose, they allege misrepresentations, not just a failure to disclose, and they say that although you try to distance yourself from the preparation of the loan tape and the term sheet, your fingerprints were over the loan tape and the term sheet, and you passed it on to them with your logo, your signature, in effect, and they relied on those documents.

MR. HAIL: I will say two things about that. The first is as to the loan tape, it's origination material. That undoubtedly comes from WMC. They knew that and they allege -- they took that data and modeled other WMC data. The prosup then says specifically that data came from WMC.

THE COURT: Yes, but you passed it on allegedly with your own logo, which they say you knew were not correct.

MR. HAIL: Your Honor, there is two things. The first is the knowledge and the scienter part about whether or not we knew it was correct. I think that will be clear when we get to that. We told them it was WMC data. We specifically disclaim making representations about it. It is very clear who makes what representations. Those are carefully negotiated in any RMBS deal, whether there is a no fraud rep, whether there is a representation by the sponsor that it backstops the

originator's representations. They undoubtedly have the benefit of the originator representations as to the quality of the loan data. What we then represent and stand behind is specifically negotiated, was specifically referred to in the prosup.

THE COURT: You're referring to the supplemental prospectus as to what you said.

MR. HAIL: Exactly. That refers to a different agreement for the specific representations we made.

THE COURT: But there is no specific representation with respect to the loan tape and the term sheet that you give to them and that they allegedly rely on. The supplemental prospectus may have its own clarification and specific portions as to what you're saying and what the originator says, but there is nothing like that in the loan tape or the term sheet.

MR. HAIL: There is two things. Let me focus on the loan tape. That's a series of data. It is numbers and it's number crunching. There is not a specific disclaimer. It's an XL spread sheet file. Those are loan characteristics which they knew came from WMC. They know that because that's what they said they did, they modeled WMC deals. They didn't model RBS deals.

For the term sheet, the term sheet, the second page says, Originator, WMC mortgage corporation. The term sheet also contains disclaimers in the front of it which say

specifically this is preliminary. The second one says if you get a prosup, the prosup supersedes and replaces the information and refer to the prosup. I think the prosup makes it perfectly clear that the information the source of all the loan data, the source of the information, is WMC itself.

The question is, did we misstate what the originator told us? That was the analysis that was done in *Union Central*. We can look at that. We didn't make a misrepresentation because we are reporting back. WMC told us this loan data. We then told it to third parties. The question as defined in the *Union Central* case is, did we misstate what was said to us by the originator. That is relevant both to the misrepresentation piece and also to the scienter piece, because there is no allegation we knew that that information -- there is no factual -- specific factual allegations.

THE COURT: I thought that, in fact, they do allege that you knew that the loans were not collectible in the degree to which they should have been collectible, because you knew that the quality of the loans was far less than would otherwise meet the underwriting standards of the originator.

MR. HAIL: There is no specific factual information that tie any of that scienter to the specific loans in this transaction, and the specific nature of this underwriting in these loans. They do have a whole section on scienter which we can get to later which talks about the Clayton trending

reports, which talks about other lawsuits, that talks about other things that allegedly provide scienter. Not a single one of those allegations ties to this transaction, to these loans.

The only specific thing we know is the diligence report in this case, the diligence report that showed what the evaluation of the underwriting materials was, the compliance with guidelines, things like that. That was shared with them specifically.

This case is different, I said for three reasons. The first of which is the fact that we were not the originator. The passing of the information and our knowledge of that information is significant.

In a recent decision Judge Torres -- this is after the briefing in the case -- this is 2013 WL 6667601, and it's Deutsche zentral-genossenschaftsbank -- which I will call DZ Bank v. HSBC, December 17, 2013. The court found where it's a third-party deal, even that case the subsidiary originated some of the loans, if the underwriter itself did not actually look at the loans and possess the information, there is nothing that suggests that, in fact, they knew the information was wrong. You need to have a specific tie to the specific loans in the case to the specific underwriter that tells somebody at RBS's position that the loans are bad, that they weren't written within the guidelines. The only thing in this case that would provide the best evidence of that is the diligence material.

In this case we disclosed the diligence material to them. They don't allege that we disclosed the diligence material, but the distinction in the case -- and that's the second major distinction in this case -- is that there is no allegation that we failed to disclose the diligence materials. If you look at any number of our RMBS cases, particularly on the seller's side, the allegation is that the sponsor underwriter did not disclose what the diligence reports it knew in its files.

THE COURT: What did Judge Torres eventually do it with the motion?

MR. HAIL: She dismissed the complaint.

In that situation, where the court finds that the knowledge contained in the diligence report is significant, it's evidence that you knew something was wrong with the loan pool. In fact in this case we disclosed that same information. The distinctions in the cases finding scienter is the diligence in this case was, in fact, disclosed. I'm only aware of one case where a sponsor was held -- a fraud claim survived where the diligence had been disclosed. It was *MBIA v. Countrywide*. In that case, in fact, the allegation was the representations were made about the diligence and what you would do with the diligence. That, in fact, the loans were not then kicked out, that the diligence problems were not then solved. Other than that, I'm not aware of a case where the diligence has been shared with the third party, with a monoline and in fact

there's been evidence of scienter found.

The third reason in this case, which makes it unique, is the release. In this case to get the diligence materials we required the execution of an acknowledgment and a release. The release is very broad. It is not limited to the contents of the diligence itself.

THE COURT: You begin your papers with the argument from the release. The release was not pleaded as part of the complaint. It was not referred to in the complaint. It's not integral to the complaint. I couldn't rely on it without turning it into a motion for summary judgment.

I know you make an argument that the complaint was deliberately drafted to avoid reference to the release, but that's not really true. They are certainly not relying on the release as the basis for their arguments in the complaint. They are just not. The release is a defense, which would normally be pleaded in an answer, and then you would have a motion for judgment on the pleadings, taking into account the release. But it's not a 12(b)(6) motion. I don't believe I can consider the release on a motion to dismiss.

I also know you say that the release is integral because you produced documents in connection with the release, so they can't rely on those documents. But that still doesn't make the release integral to what they pleaded. They say, We're not relying on the documents that were given to us in

connection with the release. You say, Yes, you are. When you get through at the end of the day you can hardly say that even if you considered the release, which I don't think I can, that there are no issues of fact, and this could be decided as a matter of law.

MR. HAIL: Your Honor, I think, first of all, that the release is integral to the complaint and I think they reference -- there is two ways that it is. First, they reference the dialogue and e-mail exchange of information between the parties.

THE COURT: Do you really think that they are relying on the release as an element of their claim?

MR. HAIL: No.

THE COURT: Usually the way in which it comes up is a party can't claim breach of contract and not include the contract as part of their complaint, because there is another provision of the contract that will blow their claim out the window.

That's not this way at all. The release is very much a defense to the claims that they make in the complaint. It's hardly integral to the claims that they make in the complaint.

MR. HAIL: I think there is two answers to that question. The first is the sequence of exchange of information they talk about references various e-mail communications. As we put in the Hail declaration, Exhibit A, the e-mail exchange

includes the very release and information that we're talking about, the diligence materials. It's as if they asked us question saying, Gee, are there any bad loans in the deal? Then they make allegations and then we answer it say, no or yes or whatever that would be. It's as if they only played half that conversation.

I think when they reference the communications between the parties, the exchange of information between the parties, they have alleged and included that. Specifically, paragraphs 49 and 50 talk about the e-mail exchange and reference the e-mail exchange. I disagree. I think they very artfully and disregarded the release. We included it in our first round of motion papers in our motion to dismiss. They plainly knew it was there. They are plainly aware of it and have plainly avoided it.

THE COURT: The issue is not whether they knew about the release. Of course, they know about the release. The issue is whether the release is integral to the claim that they have pleaded so that they have attempted artfully to plead around the release. Putting aside that the release is not pleaded and it's not attached and it's not referred to in the complaint, they say, We are not relying upon the release, and I believe that they say the documents that we were given in order for which we gave the release are plainly not the documents we're relying on for our claims in this case. That's what they

say.

Admittedly, in thinking about it, there are lots of questions of fact that may come up, which may limit the claims and may limit the damages and may cast doubt on the credibility of their claims of scienter when you compare what they got for which they are making a claim on, and what they got in exchange for a release, because you didn't want to give up this information without a release. So they got that information pursuant to the release. So now you have to look at the information they got in response to the release, and compare it to the other information, and ask can they reasonably have relied upon the information that they got before and the information in the prospectus supplement, and not include this information that they got in return for the release. Or don't they at least have to reduce their claims or modify their claims in order to exclude that information and didn't that information put them on sufficient notice so that reliance on the other information is no longer reasonable?

Putting aside the fact that the release is not pleaded, is not integral to their claims, could I decide those issues on a motion to dismiss?

MR. HAIL: You don't have to decide those issues on the motion to dismiss. The release is not a release of claims that relate to misstatements or what is said in the information itself. The release is much broader than that. The release

says, Any claim expense, cost, etc., relating in any way to or arising out of.

THE COURT: Yes. The interpretation, we're several pleadings down the road, but the interpretation of the release and what it covers also raises issues of fact. It doesn't in your mind, I realize that. But step back just for a moment. RBS doesn't want to give information that it has not completely betted and doesn't want someone else to be relying on it. You say, Look, before I give this information we want a release. So you can look at this information, we will give it to you, but we don't want to be sued on the basis of this information. Then they say, Okay, we will give you this release.

Now you say this release was really a get-out-of-litigation-free card. In order to get this information, you won't sue us at all based on anything to do with this transaction. In order to get this due diligence information, you won't sue us at all, on anything, not only arising out of or relating to the information we're giving you, but you have, in effect, overnight, in order to get this information, given us a free pass for this entire transaction. One would question, is that the real meaning of the release? Are there any issues of fact with respect to how this release should be interpreted? You say no, right? This release was "we cant be sued at all for this transaction."

MR. HAIL: I think what the release says is that the

release -- they can't sue us claiming they didn't know the contents of the loans and the loans files. Any case, any claim that involves the diligence, the accuracy of the diligence, the presence of diligence, what the diligence revealed, the subject matter.

THE COURT: What could they sue you on in connection with the transaction?

MR. HAIL: They could sue us on perhaps if we didn't have title to the loans. I don't know.

THE COURT: Why wouldn't that relate to the information?

MR. HAIL: It wouldn't implicate the diligence.

THE COURT: Why not?

MR. HAIL: In this case one of the allegations, scienter, was the fact we had the Clayton reports, the Clayton trending reports, all of these other diligence reports.

THE COURT: Why would it be anything to do with the collectability of the loans?

MR. HAIL: Not the collectability. I think about the underwriting and compliance with standards, the information provided, if you can track that back to what's in the diligence.

THE COURT: Isn't part of the underwriting for the loans a determination of whether the documentation of the loans is sufficient to pass title?

MR. HAIL: I'm talking about a different. I'm not talking about whether or not the loan itself was properly underwritten such that there was an existing security interest. That could be a defect uncovered in the diligence. I'm talking about the paper flow from originator to sponsor to third party into the trust. If something is wrong with that chain, for example, there have been claims brought like that, that the diligence itself wouldn't effect that kind of claim. But if you're arguing in this case that, I didn't know about underwriting defects, I didn't know the level of underwriting defects, in order to get the diligence, you agree to release the claims and arguments that I didn't know, that I got defrauded, that I didn't know about the compliance. I think that's squarely on point. I think that's exactly what their scienter, when they talk about Clayton reports, attempts to impute to us. They argue all the other diligence reports are evidence we should have known of something, but not the specific diligence reports in this case.

THE COURT: I know. They say they are not relying on that specific report for their allegations.

MR. HAIL: But they attempt to create the fact that there is scienter from all of these other reports that are significant, that somehow are another RBS did know something other than the specific one that relates to this specific deal. Other Clayton reports have been specifically rejected as

evidence of scienter as they relate specifically to RBS, and the Stichting Pension Funds case. Those other Clayton reports are not evidence of scienter, but that's where they catch themselves. If the diligence reports in this case and the diligence, what it reveals, the method it communicates allegedly imputes scienter to RBS, this claim necessarily involves the diligence and relates to the diligence. You don't have to come up with some outlandish construction of whether or not there is a chain of title dispute that relates to the diligence materials. It is squarely going to be a defense. It is squarely at issue. Squarely part of the materials they requested. They wanted to do the deal. They just blindly ignore it. That's how this specific claim is released. That's why this specific claim is covered by this release. Exactly what was intended at the time.

THE COURT: Why I suggested to you before the release may be relevant to a defense in the case, and it may limit their damages and it may constrain their ability to make various arguments in the case, first of all, those raise issues of fact. Secondly, they don't establish why the release, which is not pleaded and is not incorporated by reference into the complaint, can be considered on a motion to dismiss.

MR. HAIL: I think the law is that if they have knowledge of it and they plead around it, that we shouldn't have to be put through all the other necessities.

THE COURT: The law in the Second Circuit is clear after *Chambers* I think, that it's not enough that the plaintiff was aware of the document, had access to the document, had the document, but the plaintiff had to "rely on it," for purposes of bringing the case.

MR. HAIL: In this case, I think they relied on it to avoid talking about it. It is clear that they didn't mention the diligence. If the diligence materials had shown no defects and there was no release, I'm a hundred percent confident that we would have heard in the complaint that there was a diligence report provided to us which showed no problem at all.

THE COURT: So they can't rely on that due diligence report that was given to them, in return for their giving the release. So they don't. You say, Well, what's left is insufficient for purposes of reliance and scienter. Second, we will win because what we gave them put them on sufficient notice, and we got a release for that. But that's a defense. It's surely not part of their claim.

MR. HAIL: Your Honor, I think there is a couple points in there. I say, obviously, you are right, but other than the last part.

THE COURT: Thank you for that one.

MR. HAIL: The fact we share the diligence is lack of the scienter, evidence of the reasonable reliance. We think absent those allegations, the case falls away period. Putting

aside whether the diligence was shared with or without a release, we think the complaint didn't survive. If you look at the case law that up upholds and allow these cases to consider, they are almost universal, the diligence is not shared. The results of those diligence shows defects if the loan pool that was withheld from the third party, be it the no purchases or monoline.

You are correct that whether or not there was a release in this case, the sharing of the diligence is a significant difference in the matter. But secondly, the release is not limited to, We won't rely on the contents of the diligence and sue me on the contents of the diligence. The release is actually drafted much broader, and it's entirely within the Court's purview to look at whether this claim relates in any way to the diligence materials. Is it going to be a defense? Is it going to be an element of what they relied upon one way or the other. If the answer to that question is yes, and you can decide that now, this case -- the claim ought to be dismissed. You don't have to worry about what else the release might do. You don't have to worry about what they contend they didn't rely upon or what the diligence showed. The fact that you are asking yourself the question is the diligence going to be considered in that quantum of information, I think in their reply brief that specifically point through a series of fact issues they think that it

raises. What the did the diligence show? How did we use it? They say those are fact issues which you can't decide now. In reality, the fact that you have to ask those questions means the release is implicated. The language in the 1344(b), 28 U.S.C. 1344 (b), which is bankruptcy court jurisdiction speaks to cases arising in or relating to bankruptcy. We all know the construction of relating to jurisdiction and bankruptcy is extraordinarily broad.

THE COURT: Please.

MR. HAIL: Justice Alito went through the same analysis in looking at what a forum selection clause should be.

THE COURT: You are very far down the line to attempting to construe the meaning of the release and far away from whether the release was pleaded, incorporated by reference or integral to the complaint.

MR. HAIL: I think that it is integral. We have had this dialogue. The reason it's integral is because the sharing of information and what that information means necessarily includes the diligence material. They have just stopped the conversation mid-sentence. And then they go on to talk about diligence materials, but not these diligence materials. The fact that they ignore it is obviously article pleading around it, and their whole theory has to encompass this exchange of information with RBS. That's the reason it's integral. That's the reason it was relied upon. They plainly knew about it.

They did want to talk about it. They didn't want to have this dialogue at this time. They wanted to artfully avoid it.

THE COURT: I have your point.

MR. HAIL: Moving on to the specific misstatements, we have said in the past that the release takes out all the claims.

THE COURT: I should have asked you for an estimate of time at the beginning. Second Circuit would give 12 minutes. We're now at about half an hour, 40 minutes.

MR. HAIL: I will make two quick points, your Honor.

The term sheet itself says it's superseded if you get a prosup. The term sheet is an incomplete document. It has gaps in it. Specifically, the deal changes, the amounts change, it is plainly a draft document. The tranches change, the amounts change. So any reliance upon the material in the term sheet is by its terms superseded by the prosup and also it in and of itself not accurate because it is specifically a draft document. It is a term sheet. It is not the deal.

The prosup then contains the very clear attributions of language to WMC. There is no allegation in the case that we mailed to report or mistakenly or knowingly misstated what WMC told us about the loans. That allegation is simply isn't there.

Those are the two things I will like to point out.

THE COURT: Thank you.

MR. MAHER: Your Honor, good afternoon. Bill Maher on behalf of plaintiff, Assured Guarantee.

It's obvious from your Honor's comments that you are very familiar with the facts of this case. I'm going to try to skim over them as quickly as I can. I think there are some that I need to call to your attention.

Obviously, this transaction has been a complete disaster, horrific losses, horrific performance by an RMBS that was structured by RBS known as Soundview. It's a 1.1 billion securitization. Losses as of June 25 last year are 434,000,000, 39 percent of the aggregate balance of the loans and of the remaining amount, 61 percent are 60 days or more delinquent. That's paragraphs 12 and 70 of our complaint, your Honor.

With respect to the group two loans which we have wrapped, those are equally bad in terms of losses. About 39 percent, $157,000,000 out of 362 that was the collateral pool, and their performance thereafter has been even a little worse than a aggregate. That's in paragraph 71. Assured projects more than a hundred million dollar loss with respect to this insurance policy. That's paragraphs eight and 14.

As you noted, they approached us for an insurance wrap with respect to the class two certificates. They advised us the transaction was going to close in about two or three weeks. As you noted they gave us two documents initially. They gave

us on March 1, 2007, the loan tape. That contains loan-by-loan information, a lot of detail that I have heard you discuss. That's paragraphs 45 and 46. On March 7 they gave us a loan tape again and gave us the term sheet. As you noted, neither of those documents contain any disclaimers with respect to this information was provided to anybody other than RBS. In fact, their fingerprints are all over it, we allege the metadata in the documents, the logos are all RBS-related information.

The terms sheet described the structure and extensive information concerning the mortgage loans in the face of its states it's an RBS document.

The mortgage loan information set forth in the loan tape and summarized in the term sheet is set forth in paragraph 53 of our complaint, your Honor, talks about the debt-to-income ratio, loan-to-value ratio, combined loan to value and other information.

Now, I would like to address just briefly the Hail declaration. I understand your Honor is not inclined to consider the release in some of those documents. I want to point out why it's significant.

Exhibit A to the Hail declaration attaches not just what was referenced in the complaint meaning the e-mails up until March 7 when the documents were transmitted to also, it also attaches e-mails thereafter from March 8 to March 12. Those are nowhere referenced in the complaint, your Honor.

They are completely deorder the complaint, and they added it as a factual matter that is not part of our case. They also attach as Exhibit D a release dated March 9, which is not referred to in the complaint. I refer to them because they are timeline in terms of the dates of what happened here, but I do not intend to address them as part of my factual presentation because they are not part of our case.

THE COURT: Let's pause just for a moment.

The point I was making with Mr. Hail is, yes, by avoiding addressing the release, you may survive under the rules a motion to dismiss, because you don't plead the release. It's not relied upon for purposes of the complaint, but then the question becomes is it really a viable case or is it a case brought solely to get over a motion to dismiss.

You have a lot more material with the release. You gave a release in order to be able to get that material. Then the question becomes how reasonable, plausible is it that given all of the materials that you receive with the release, which you agreed you wouldn't sue on, how reasonable, plausible, is it that you could have relied upon what was left, and how reasonable or reliable is it that the RBS people were attempting to defraud you or reckless in what they were doing if they were prepared to give you the materials that they gave you with the release.

Is this an artfully pleaded case in order to get

beyond the motion to dismiss? These things would have to be considered on a motion for summary judgment. Is it really a case that's brought for purposes of eventually obtaining a relief on the merits before a jury at the end of the case? Or for some other reason?

MR. MAHER: Your Honor, the case was brought because there were horrific losses.

THE COURT: Yes, I know. Both sides should give me a modicum of credit. Of course, it's brought because there were enormous losses. The question becomes whether those enormous losses are compensable because of what the defendants did. Are they compensable under the standards set out by the law? Or is this a case in which the plaintiffs say, We suffered enormous losses, therefore, you must pay?

MR. MAHER: No, your Honor, that's not this case.

I will tell you, and you've hinted at some of them in terms of the fact issues that are going to have to be unpacked with respect to what the implications of this are, I will tell you and I think this is complete dishonest, but it's one thing that they have said. They say in their brief and in their reply brief we received the Clayton report on Soundview, the initial pages on six and seven and reply brief on page two. There is no support whatsoever for that assertion, either as a matter of pleading or as a matter of fact. We never got a Clayton due diligence report.

THE COURT: On Soundview.

MR. MAHER: Exactly.

If you go outside the record, your Honor, and click on the icons, it is not a Clayton due diligence report. I'm not saying we should do that. It's completely improper.

THE COURT: Trust me, I don't go beyond the papers that are submitted to me.

MR. MAHER: What I'm saying, your Honor, is the representation they have made to try to get you to move five steps ahead in this case are not accurate. The reality of the situation will ultimately be presented to your Honor in terms of what happened here and what we believe to be are compensable losses that we think we were defrauded into wrapping this structure.

Yes, the release is not part of their case. It is their affirmative defense under 8(c)(1) under the Federal Rules of Civil Procedure. We have not pled it. *Chambers*, as you indicated, you Honor, is clear law in the Second Circuit saying that's not part of our case.

THE COURT: What were you given then along with release in terms of due diligence materials?

MR. MAHER: We were given some materials, your Honor. I would rather not go into the factual deorder the record issues because it gets us into an issue we don't need to go to today and I believe will ultimately vindicate us in terms of

that we were defrauded into entering into this transaction.

THE COURT: All right. You couldn't reply on any of those materials that you were given, along with the release, as a basis for your claim because you gave a release with respect to those materials.

MR. MAHER: Your Honor, I don't want to debate that, to be honest with you, because the release is not properly before the Court.

THE COURT: Okay.

MR. MAHER: With respect to the prospectus supplement, your Honor, I can this is important, moving forward in the chronology on March 13, 2007, RBS provided Assured with the draft prospectus supplement dated March 9, which cover page bore the names of all three defendants. That's in Paragraph 55 of our complaint. The draft prospectus described the quality and characteristic of the mortgage loans and underwriting practices guidelines used in originating the loans. It says that the mortgage loans were originated in accordance with prudent underwriting practices and that information that was critical was verified and checked. It says that 99 percent of the borrowers in the pool had DTI less than 60 percent and 89.5 percent of the borrowers had DTI of 50 percent or less. The same statements appear verbatim in the final prospectus supplement, which RBS provided to Assured on March 20, the day before Assured agreed to issue its insurance policy on

March 21, 2007. That's paragraphs 55 and 68.

Your Honor, if I might, I would ask you to turn to the prospectus supplement.

THE COURT: I have tracked it through. I understand that there are qualifications, but the qualifications don't explicitly qualify the language that you are looking at.

MR. MAHER: It's more than that. I would like to point it out to you. It's page S29, which is their first, what they call get-out-of-jail-free card. With respect to the mortgage pool, they rely on the first sentence under Mortgage Pool, "The information set forth in the following paragraphs is based on searching records and representations about the mortgage loans that were made by the originator at the time it sold the mortgage loans." That's page S29, your Honor, Exhibit C to the Hail declaration.

THE COURT: I have it.

MR. MAHER: Based on, your Honor, does not suggest exclusively based on without verification and will not be checked or verified by RBS. In fact, if you look down in the next paragraph, your Honor, the very next paragraph, the middle of that paragraph, it's about halfway down, it starts, "The depositor believes that the information set forth in this prospectus supplement with respect to the mortgage loans will be representative of the characteristics of the mortgage pool as it will be constituted at the time the certificates are

issues. Although the range of mortgage rates and assurities and other characteristics of the mortgage loans may vary, any statistic presented on a weighted average basis or any statistic based on the mortgage loans is subject to a variance of plus or minus five percent." It goes on. "If any material pool characteristic of the mortgage loans on the closing date differs by more than five percent, or more from the description of the mortgage loans in this prospectus supplement, the depositor will file an updated pool characteristics by form 8K within four days following the closing date."

Your Honor, this language clearly states and suggests that RBS is actively monitoring the mortgage pool for compliance with the characteristics contained in the prospectus supplement.

Turning your Honor, if we could, to their next issue that they quote just part of the language from this prospectus supplement, if you turn to page S85, there's again, if you look there is a caption, the Originator as that heading.

THE COURT: I know.

MR. MAHER: Then it says General. The information set forth in this section.

THE COURT: I know.

MR. MAHER: Has been provided by WMC Mortgage.

THE COURT: It arguably refers to the section entitled General and not to the next section, which is Underwriting.

MR. MAHER: Exactly, your Honor.

There is no qualification about the underwriting standards. If you look for comparison, your Honor, on page S98, it says Servicer, it doesn't have that sentence under one of the subheadings. It's the first sentence right under the Servicer. "The information in the following paragraphs has been provided by Countrywide Home Loan Servicing." Then it goes after and talks about the paragraphs.

Your Honor, we're entitled to a motion to dismiss, we are entitled to an inference that that sentence should have been up above General if it was intended at all to apply to all the preceding paragraphs.

Assured reasonably relied upon the modeling -- used in its modeling analysis upon the information provided by RBS, Paragraph 56 of our complaint. Our complaint talks bout the cash flow model, the expected loss model, specifically and significantly, your Honor, we had no interaction with the originator of the loans, WMC Mortgage. That's alleged in paragraph seven.

In addition as RBS knew, Assured had no access to and no ability to access the underlying loan files and had to rely upon RBS information. That's paragraph 735 and 61.

Assured alleges that it would not issued the insurance policy without the representations made by RBS in and by tendering the loan tape, the terms sheet and the prospectus

supplement. That's paragraph 67.

Following the shocking performance of the Soundview transaction, Assured commenced an investigation. That's paragraph 72 of the complaint, your Honor. Although we had no right to obtain the underlying files, the certificate holder for the class 2 certificates did and in March 2010 authorized us to obtain and review those. Our forensic review took 14 people working for three months. It confirmed WMC had utterly failed to adhere to its underwriting guidelines in originating the mortgage loans; and two, materially important characteristics of the mortgage loans did not conform to the information provided by RBS in the loan tape, the term sheet and the prospectus supplement. Assured reviewed virtually all of the loan files, 1,588 of the 1,593 loans of the group two mortgages. Of those loans more than 1,444, 91 percent of them, materially violated one or more of RBS's representations to Assured. That's paragraphs 11 and 73.

The misrepresentations were pervasive, but included excessive DTI, excessive LTV, unreasonable stated income, failure to verify that borrowers assets were sufficient, insufficient borrower reserves, failure to verify employment, failure to investigate credit history. That's paragraph 76.

The misrepresentations are detailed in paragraph 72 to 82 of the complaint, your Honor. And had Assured known of these misrepresentations they never would have issued the

policy. That's alleged in Paragraph 82.

I would like to turn, if I could, to the scienter issue, and their knowledge of the falsity.

As your Honor indicated, we have alleged many different ways in which RBS had knowledge, let alone scienter, that these mortgages were -- the information they provided us was materially inaccurate. First, the pervasive nature of the breaches as verified by a forensic review of virtually every loan file revealed a 91 percent breach. We've particularized that specific allegation, your Honor, with a former senior vice president of RBS of asset-back financed, we refer to them as confidential witness 22, who was copied on e-mails in this case and described Soundview as, "one of the worst" and "really a piece of garbage." That's paragraph 100 of the complaint.

Second, RBS had a practice of placing loans into securitizations that it knew were defective and not in compliance. Again, we particularized that with the Clayton testimony before Congress and the Clayton reports that were submitted in connection with that testimony, Paragraphs 87 to 91, in which Clayton representatives testified RBS regularly would resubmit noncompliant loans into the portfolio for securitization. That were EV1 loans which were loans that were complied with the guidelines. There were EV2 loans which are loans that didn't comply with the guidelines, but had exceptions that were acceptable. There were EV3 loans which

didn't comply with the guidelines and had no compensating factors. The EV3 loans alone, RBS would put back more than half of those loans into the securitization pool. So RBS knew it was doing this during the relevant period. Again, the testimony of Clayton executive relates to 2006 and the first part of 2007, which is exactly the period for the securitization at issue in this case.

THE COURT: By the way, are you familiar with Judge Torres's decision.

MR. MAHER: I am not. I was not given notice it was going to be raised today.

THE COURT: That's fine.

MR. MAHER: Third, your Honor, we have alleged that RBS made efforts to intimidate and fire loan appraisers and reviewers who rejected too many loans. We particularized that, your Honor, with a former Clayton employee who we identify as confidential witness 11.

THE COURT: I'm familiar with the allegations, I really am.

How much more time do you need?

MR. MAHER: 15 minutes, your Honor.

THE COURT: No.

MR. MAHER: I will quickly move forward then. I understand.

Let me just get the categories out, your Honor.

THE COURT: I'm really familiar with the facts and the law on the motion, and Second Circuit would give 12 minutes. Regularly ten. So far we've gone on about a half an hour.

MR. MAHER: I think I have only been up about 15 minutes, your Honor.

THE COURT: Maybe you are right. Maybe your colleague used up more time than I thought.

MR. MAHER: I want to be responsive to the Court's concerns or issues. If there are any issues I can address for you, I would be happy to do that.

THE COURT: I do not see how your claim for a violation of the insurance laws survives the appellate division decision in *MBIA*.

MR. MAHER: Very well, your Honor.

As we read the decision, and I understand from what you're saying, your Honor, you don't read the decision that way, the first department held that we could have a damages remedy -- compensatory damages remedy under 3105. You can't get rescission.

THE COURT: You cannot get rescission and you cannot get, they say, rescissory damages.

MR. MAHER: Yes.

THE COURT: They explain why that's true. You can't avoid the import of the decision by seeking the same damages and relabeling them under another name.

MR. MAHER: I think that's what the Court did, your Honor. I think that's exactly what the first department did.

This is an insurance context. An insurer issuing a policy based upon a false statement, you don't need scienter. You don't need knowledge of the falsity, even an innocent representation is sufficient to avoid the policy under 3105 or qualifies under 3105.

THE COURT: At the end of the day, after the appellate division decision in *MBIA*, the claim for damages, period, under the insurance law, was rejected by the appellate division.

MR. MAHER: The rescissory damages was rejected, your Honor. That was the only damage alleged in that case. However, your Honor, to me, the language is very clear. Obviously, you disagree with that. The *MBIA* court says although the insurance law provides for avoiding an insurance policy or rescission, it also mentions defeating recovery thereunder, which logically means something other than rescission. Then they go on to say neither defendants, nor the federal cases on which they rely, explain why defeating recovery thereunder cannot refer to the recovery of payments made pursuant to an insurance policy without resort to rescission. That's what we're seeking.

THE COURT: Then they refer to that as rescissory damages. They explain why those are not recoverable.

MR. MAHER: That's not how I read the case. I

understand that's how you read the case. I respectfully disagree with that. They were talking about rescissory damages because that's all that were alleged. But they are saying you can get damages, other than rescission, because you can't get rescission, you can't get rescissory damages, but you can get other damages, that's what the first department is saying here. This, from our perspective in terms of people who do this side of a work is a path-breaking decision that is a positive for the monoline financial guaranty insurance companies.

THE COURT: There is no other case that reads it that way.

MR. MAHER: There is no other case. This case was just decided, your Honor, in April of last year. There has been no subsequent New York case that has, as I understand it, gone forward to explain further the debate that you and I are having, which is are you right -- and of course, you are the judge -- that what the first department is saying is that you are out of luck, you have no damages at all; or what I'm saying, which is you can't get rescission because you are monoline financial guarantee company who swore off rescission and you cant get rescissory damages; however, the statute says defeating recovery means you can get damages for violation of the statute.

THE COURT: Okay.

MR. MAHER: Your Honor, we're not seeking to rescind

the policy. We are seeking damages.

THE COURT: I know that. Your complaint makes it clear you are not seeking rescission. The briefs refer to the fact that you are legally unable to seek rescission under the terms of your insurance contract, right?

MR. MAHER: Yes.

THE COURT: In addition, the appellate division describes that as inability to seek rescission. They also describe it as this is not a case where rescission would be impracticability. They disagree with the lower court. It's not a question of impracticability. It's a question of legal impossibility.

MR. MAHER: Your Honor, again, in terms of reading how this decision is written, admittedly it's not a fulsome as it might be, and we wouldn't have to have this debate.

THE COURT: Your interpretation would be completely different anyway, because your suggestion is they are leaving open a possibility of damages that were never even sought in the case.

MR. MAHER: No. What I'm saying is they are construing the statute in a way in which they are saying that a remedy is available under the statute. They did that in the course of deciding the case in front of them.

Judge, if we look at how this is drafted, the part I read says that you can get some other relief. Then they go on

and say the court erred, however, different than this. This is a positive, the Court erred, however, in granting summary judgment on the issue of recessionary damages. That is a separate point they are talking about, as opposed to one I'm talking about.

I understand and I respect that you may have a different view of this. I am conveying to you and I know this from talking to many people in the industry, your construction of this -- if that's in fact what you ultimately rule, your Honor -- will be a shock and a surprise to everybody in the industry who believes that this is a positive for the monolines.

THE COURT: If I don't dismiss case it will be a shock and surprise to your colleague on the other side, telling me that there has never been another case that's quite similar to this that has not been dismissed out of the box.

MR. MAHER: Very well, your Honor.

I'm happy to address whatever questions you have.

THE COURT: Which way would you like to be shocked?

MR. MAHER: I would like to be sustained in terms of a moving forward with the case, your Honor. I'm not sure I want to be shocked.

THE COURT: Okay.

MR. MAHER: Can I address any other issues for you?

THE COURT: No. I think that's fine. Thank you.

MR. MAHER: Very well. Thank you, your Honor.

THE COURT: Anything further, Mr. Hail?

MR. HAIL: No, your Honor. I could, but nothing something clarification.

THE COURT: On the insurance law issue?

MR. HAIL: Should I approach?

THE COURT: Sure.

MR. HAIL: On the insurance law issue your Honor gets it exactly right, the *MBIA* case, I'm intimately familiar with. My firm was on that case, and I think it is right.

As to what the monoline insurance, how that interpret that as a great victory I'm surprised giving the lack of the remedy. In fact, I think Mr. Maher said there has been no other cases that have interpreted it. In fact, in our reply brief we cite two specific cases that had come out similarly. That's in footnote 36 in the reply. Specifically, if you take a look at *CIFG v. Bank of America*, 2013 WL 5380385, New York County September 23, 2013, *Home Equity Mortgage Trust v. DLJ*, 2013 W L5314331, both of which fine no remedy.

In similar context, this is a case where they made an irrevocable policy. There is no dispute. We put that in. They have waived their ability to rescind, therefore, their damaged area is gone.

As to Mr. Maher's idea that they just said you can't call it rescissory damages, they meant to allow a claim for

compensatory damages, that's not what the case says. That's not what the insurance code says. That would be a-path breaking interpretation of the law out there. That's the point I would like to make on that.

THE COURT: Thank you.

I'm prepared to decide.

This case arises out of certain residential mortgage-backed securities, RMBS, transactions in or around March 2007. The plaintiff, Assured Guaranty Municipal Corp. (Assured), a monoline insurance company, brings this action against the defendants RBS Securities, Inc., (RBS Securities) RBS Financial Products, Inc. (RBS Financial), and Financial Assets Securities, Corp. (FAS), collectively RBS.

The plaintiff alleges that in connection with RMBS sales, the defendants obtained an insurance policy from the plaintiff by fraudulent misrepresentations. The plaintiff asserts claims for fraud, aiding and abetting fraud and violation of the New York insurance law. This Court has subject-matter jurisdiction under 28 U.S.C. Section 1331, based on the complete diversity of citizenship between the plaintiff and the defendants and on the requisite amount in controversy.

The defendants now move to dismiss the amount amended complaint in its entirely pursuant to Federal Rules of Civil Procedure 12(b)(6).

In deciding a motion to dismiss, pursuant to Rule

12(b)(6), the allegations in the complaint are accepted as true and all reasonable inferences must be drawn in the plaintiff's favor. *McCarthy v. Dun & Bradstreet Corp. 482 F.3d 184, 191 (2d Cir. 2007); Arista Records LLC v. Lime Group, LLC, 532 F. Supp. 2D 556, 566 (S.D.N.Y. 2007*).

The Court's function on a motion to dismiss is not to weigh the evidence that might be presented at trial, but merely to determine whether the complaint itself is legally sufficient, *Goldman v. Belden 754 F.2d 1059, 1067 (2d Cir. 1985*). The Court does not should dismiss a complaint if the plaintiff has stated enough facts as state a claim to relief that is plausible on its face. *Bell Atlantic Corp. v. Twombly, 550 U.S. 554, 570 (2007*). A claim has facial plausibility when the plaintiff believes factual content that allows the Court to draw the reasonable inference that the defendant is libel for the misconduct alleged. *Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009)*. While the Court should construe the factual allegations in the light more favorable to the plaintiff, the tenet that a court must accept as true all of the allegations contained in a complaint is inapplicable to legal conclusions. Id.

When presented with a motion to dismiss pursuant to Rule 12(b)(6), the Court may consider documents that are referenced in the complaint, documents that the plaintiff relied on in bringing suit and that are either in the

plaintiff's possession or that the plaintiff knew of when bringing suit or matters of which judicial notice may be taken. *See Chambers v. Time Warner, Inc. 282 F.3d 147, 152 (2d Cir. 2002)*.

The Court accepts the plaintiff's allegations in the amended complaint as true for the purposes of this motion to dismiss. Around March 2007, RBS securitized a pool of over 4,900 residential mortgage loans, (the "mortgage loans") in a transaction known as the Soundview Home Loan Trust 2007-WMC1, (the "Soundview transaction"). RBS Financial purchased all the mortgage loans from their originator, WMC Mortgage Corp, (WMC), then conveyed the loans to FAS, the depositor for the Soundview transaction. FAS conveyed the loans to the Soundview trust, which issued various tranches of certificates representing interest in the cash flow from the payments of the mortgage loans. These certificates were then marketed and sold by RBS Securities, the underwriter, to investors.

RBS Securities, RBS Financial and FAS are all RBS entities. They operated through minny common employees are located at common office addresses with common telephone numbers.

To increase the marketability of the certificates to investors, RBS approached Assured or on about March 1, 2007 to obtain an insurance policy that would insure payments on the mortgage loans underlying some or all of the RMBS certificates.

On March 7, 2007, upon the demand of one investor who was interested in purposing the entire 291,000,000 dollar tranch of class II-A-I certificates, (the "certificates"), but wanted to have the certificates insured, RBS asked Assured to issue financial guaranty insurance with respect to this certificates. On March 21, 2007, Assured issued financial guaranty insured policy number 60125-N, (the "policy), insuring payments on the mortgage loans underlying these certificates.

To obtain the policy, RBS provided Assured certain data and documents. First, on March 1, 2007, RBS sent to Assured an Excel spread sheet known as the "loan tape," containing attributes of each mortgage loans, as well as information about the borrower and the mortgaged property. On March 7, RBS also provided Assured with a term sheet describing the Soundview transaction and summarizing data in the loan tape. The loan tape displayed a logo of RBS Securities at its top and the metadata of the Excel file also stated the file emanated from the computers of RBS securities and was last modified by an employee of one or more RBS defendants. Amended complaint paragraph 46.

The term sheet also indicated that the information therein was presented by RBS Securities and FAS. Amended complaint paragraph 50.

Finally, on March 13, RBS sent to Assured a draft prospectus supplement, which represented that, among other

things, WMC, the originator of the loans generally followed its own underwriting guidelines and originating the loans by, for example, verifying or reviewing each loan applicants' sources of income, as well as credit and mortgage payment history. Amended complaint paragraph 55.

In order to determine whether to issue the policy Assured used the data from the loan tape and the term sheet to assess risk and to project losses for the Soundview transaction with quantitative models known as an expected loss model and a cash flow analysis. Assured also allegedly relied on the representations in the prospective supplement that WMC prudently originated the loans according to prudent underwriting standards to insure that borrowers were able to make payments and that mortgaged properties provided adequate security to the loans. Assured allegedly had no access to the underlying loans files, amended complaint paragraph 51.

However, according to Assured allegations WMC did not, in fact, adhere to its underwriting guidelines and originated loans with attributes that grossly overstated the borrowers ability to pay and understated the risks of the loan. As a result, the mortgage loans underlying the Soundview transaction experienced a high level of defaults and foreclosures. As the insurer of the mortgage payments, Assured has paid over $160,000 of claims under the policy and is projecting having to pay a total of more than $100,000,000 in unreimbursed claims.

Amended complaint paragraph 108.

In addition, Assured alleges that the RBS defendants knew from the very beginning that the mortgage loans securitized in its RMBS were originated without regard to borrowers' ability to pay or adherence to basic underwriting standards. RBS not only did not cease to buy loans from WMC, but expanded its cooperation with WMC in which RBS purchased and securitized more loans from WMC. RBS also used third-party due diligence firms reviewing the loans, including Clayton Holdings (Clayton), which may be involved in the Soundview transaction, but waived in loans that Clayton found did not comply with the applicable underwriting guidelines and without regard to whether the borrower could repay the loan. Amended complaint paragraph 90.

As a threshold matter, the defendants argue that this action is barred by release signed by Assured and obtaining a due diligence report prepared by Clayton on the mortgage loans. The defendants assert that on March 9, 2007, Assured executed a letter agreement in connection with the request and receipt of a due diligence report done on the mortgage loans. Hail declaration Exhibit D, release.

In the agreement, Assured acknowledged that it was provided with certain "information" which is defined as "certain information and analysis concerning the Soundview transaction including without limitation a report prepared by

the Clayton group concerning its review of certain of the assets proposed to be included in the transaction." Release at one.

Assured acknowledge that the information may not be accurate or complete and that Assured would conduct its own assessment of the Soundview transaction and agreed to release RBS from claims, "which in any way relate to or arise out of" RBS's disclosure of such information to Assured. Release at one.

"In adjudicating a motion to dismiss, a Court may only consider the complaint, any written instrument attached to the complaint as an exhibit, any statements or documents incorporated in it by reference, any document upon which the complaint heavily relies" and any judicially noticeable matters. *In re Thelen, LLP, 736 F.3d 213, 219 (2d Cir. 2013).* Moreover, "A plaintiff's reliance upon the terms and effects of a document drafting a complaint is a necessary prerequisite to the Court's consideration of the document on a dismissal motion; mere notice or possession is not enough." *Chambers, 282 F.3d at 153.*

The release in this case is not a document in which the plaintiff relies, let alone heavily relies in drafting the amended complaint. The plaintiff also disputes whether the Clayton reports referred to in the amended complaint are the very same due diligence reports at issue in the release. The

Court could not revolve that factual dispute on a motion to dismiss, thus, this is not a case in which the plaintiff deliberately avoids attachment of or reference to a document upon and which is integral to the complaint, such as avoiding reference to a contract in a complaint that relies heavily upon the terms and effects of the contract. *Cf. International Audiotext Network, Inc. v. American Tel 62 F.3d 69, 72 (2d Cir. 1995)*.

Therefore, without converting the present motion into one for summary judgment, which neither party has requested, the Court declines to consider the release in adjudicating this motion to demiss. *See Allen v. Chanel, Inc. No. 12 Civ 6758, 2013 WL 2413068 at 6 (S.D.N.Y. June 4, 2013); Maloney v. CSX Transportation, Inc, No. 09 Civ. 1074, 2010 WL 681332, at 3 (N.D.N.Y February 24, 2010)*.

The defendants next argue that the plaintiffs have failed to state a claim for fraud. Under New York law, to state a claim for fraud the complaint must contain allegations of a representation of material fact, falsity, scienter, reliance and injury. *Small v. Lorillard Tobacco Co, Inc. 720 N.E.2d 892, 898 (N.Y. 1999)*. In addition, in alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake. Malice intent, knowledge and other conditions of a person's mind may be alleged generally. Fed. R. Civ. P. 9(b).

The defendants do not dispute, for purposes of the present motion, that the statements in the loan tapes, the term sheet and the prospectus supplement were materially misrepresentations, but argue that RBS made no actionable representation because information in these documents was provided by WMC, and that RBS merely tendered the information to Assured. However, all of these documents bore RBS's name and/or logos and the plaintiff received them directly from RBS. Amended complaint paragraphs 46, 50, 55.

The prospectus supplement makes various statements representing that the loan originator, WMC, had generally followed the underwriting guidelines, hail declaration Exhibit C at S86, which the plaintiff alleges to be false statements by RBS. Amended complaint paragraph 55.

The defendants do not deny authorship of the prospectus supplement, but argue no fraud claim can arise out of statements because RBS had disclaimed ownership. *See Abu Dhabi Commercial Bank v. Morgan Stanley Co. 888 F. Supp. 2d 431, 451-52 (S.D.N.Y. 2012)*.

The defendants point to three statements to that effect. The first statement states, "The information set forth in the following paragraphs is based on servicing records and representations about the mortgage loans that were made by the originator at the time it sold the mortgage loans." Hail declaration Exhibit C at S29.

However, this disclaimer appears at S29 and does not, on its face, purport to disclaim authorship of statements on S86, which is in another part of the document more than 50 pages away. The second statement appears on page S104 and provides that "Pursuant to the master agreement, the, originator made certain representations and warranties regarding the mortgage loans." Hail declaration Exhibit C at S104. The statement is also not an unambiguous disclaimer of authorship regarding statements about WMC's loan originating practices on page S86. Page S85, the documents that, "The information set forth in this section has been provided by WMC Mortgage Corp," Hail declaration, Exhibit C at S85. Again, it is unclear whether this statement covers the alleged misrepresentations at issue, because the language appears under the subheading "General," below the heading "The Originator," while the statements on page S86 appear under another subheading, "Underwriting Standards." Hail declaration Exhibit C at S85 and S86.

The disclaimer on page S85 would well mean that the general information about the originator was provided by WMC. The same disclaimer is not repeated under "Underwriting Standards," on page S86. Thus all of these statements are at least ambiguous as to whether they affectively disclaim authorship over the statements on page S86, on which the plaintiff relies. Amended complaint paragraph 55.

Viewing with the language in light more favorable to the plaintiff for purposes of present motion the Court cannot find at this stage that RBS did not make the alleged misrepresentations in the prospectus supplement.

With respect to the loan tape and the term sheet, the defendants have not pointed to any statement clearly disclaiming RBS's authorship. The defendants rely on the language in the term sheets stating the information "is preliminary and is subject to completion or change." That more complete information can be found in certain SEC filings. Hail declaration Exhibit B at three.

However, at this stage of the litigation it is not clear whether that language can be construed to disclaim RBS's authorship of the information provided in the loan tape and the term sheet, if at all. Contrary to the defendant's argument, the plaintiff's allegation that the information was, in fact, authored by WMC is not a concession that RBS made no misrepresentation. The amended complaint does not suggest that at the time the policy was issued Assured knew of WMC's sole authorship of the data in the loan tape.

Thus, according to the plaintiff, even though RBS allegedly knew that the information contained in the loan tape and the term sheet was materially false, (See amended complaint paragraphs 83, 85, 98, 10000 100-102), RBS transmitted these documents to Assured with RBS's own logo or name attached and

without any disclaimer of authorship inside these documents or in an e-mail transmitting these documents. With all ambiguities resolved and inferences drawn in favor of the plaintiff at this stage of the litigation, the allegations are facially sufficient to support the assertion that RBS itself made the representations of the plaintiff by adopting and holding out the false statements as its own in the loan tape and the term sheet. *See Bloom v. Mutual of Omaha Insurance Company, 557 N.Y.S.2d 614, 616 (App. Div. 1990)*; *Weisheit v. Pabst Brewing Co. 168 N.Y.S. 340, 345 (App. Div. 1917)*.

The defendants next argue that the plaintiff has failed to make sufficient allegations of scienter. Under New York law, scienter or intent to defraud includes not only knowing statements of falsehood, but also a reckless indifference to error. *Burgundy Basin Inn Limited v. Watkins Glen Grand Prix Corp. 379 N.Y.S.2d 873, 879 (App. Div. 1976)*. *See E*Trade Financial Corp. v. Deutsche Bank AG, 420 F. Supp. 2d 273, 289, n.3 (S.D.N.Y. 2006)*.

Although Rule 9(b) required that circumstances constituting fraud or mistake may be alleged with particularity, it also provides that malice intent, knowledge and other conditions of a person's mind may be alleged generally. Fed. R. Civ. P. 9(b). However, relaxation of Rule 9(b) specificity requirement for scienter allegations is compensated by the requirement that the plaintiffs must allege

facts that give rise to a strong inference of fraudulent intent, which applies to federal securities litigation, as well as state law fraud claims. *Lerner v. Fleet Bank, N.A. 459 F.3d 273, 290-91 (2d Cir. 2006); Shields v. Citytrust Bancorp, Inc. 25 F.3d 1124, 1128 (2d Cir. 1994).*

In this case, the plaintiff alleges that RBS knew a large number of mortgage loans it securitized were originated with utter disregard of underwriting standards. Specifically, the plaintiff alleges that RBS knew that a large number of mortgage loans securitized in the Soundview transaction included in a loan tape were defective. Moreover, RBS had long-standing dealings with WMC and allegedly knew that the WMC had a corporate culture of disregarding underwriting guidelines in order to generate high volumes of loans for sales to securitizations. Thus, even if RBS had no actual and affirmative knowledge about each and every defect in the mortgage loans at issue, RBS's tendering of the loan tape, the prospectus supplement and the term sheet was done at least with a reckless disregard of the truth or falsity of the statements which supports an inference of scienter. *See DaPuzzo v. Reznick Fedder 7 Silverman, 788 N.Y.S.2d 69, 70 (App. Div. 2005*).

The plaintiff's allegations are also sufficient to raise a strong inference of fraudulent intent. The plaintiff alleges that RBS approached Assured for an insurance policy in

order to sell the RMBS certificates. RBS asked Assured to issue the policy in this case because an investor was interested in purchasing the entire tranch of class II-A-I certificates, specifically demanded insurance. RBS knew that Assured would rely on the information RBS provided in determining whether or not to issue the policy, and allegedly no reasonable monoline insured would have issued the policy if the insurer knew that information RBS provided was materially false.

These allegations taken together raise a strong inference that RBS had a specific motive and intent to deceive the plaintiff in order to obtain the policy for a specific transaction. Therefore, the plaintiff has made sufficient allegations to support scienter. *See People ex rel. Cuomo v. H&R Block, Inc. 870 N.Y.S.2d 315, 316 (App. Div. 2009)*, *Houbigant, Inc. v. Deloitte & Touche, LLP, 752 N.Y.S.2d 493, 496-97 (App. Div. 2003)*.

The defendants next argue that Assured has not sufficiently alleged reasonable or justifiable reliance. Although reasonable reliance is often a fact-intensive question, *DDJ Management, LLC v. Rhone Group, 931 N.E.2d 87, 91-92 (N.Y. 2010)*, it is a condition which cannot be met, where a party has the means to discover the true nature of the transaction by the exercise of ordinary intelligence and fails to make use of those means. *Arfa v. Zamir, 905 N.Y.S.2d 77, 79*

(App. Div. 2010) aff'd 952 N.E.2d 1003 (N.Y. 2011). Only when matters are held to be peculiarly within defendant's knowledge is it said that plaintiff may rely without prosecuting an investigation. Because the plaintiff would have no independent means of ascertaining the truth. *Crigger v. Fahnestock & Co. 443 F.d 230, 234 (2d Cir. 2006)*. Thus, where sophisticated where businessmen engaged in major transactions enjoy access to critical information, but fail to take advantage of that access, New York courts are particularly disinclined to entertain claims of justifiable reliance. *Grumman Allied Industries v. Rohr Industries, Inc. 748 F.2d 729, 737 (2d Cir. 1984)*.

As an initial matter, the defendants again argue that the release precludes the plaintiff from pleading reasonable reliance because in executing the release Assured agreed to make its own independent assessment of merits and risks of the transactions. See release at one.

As explained above, the Court cannot rely on the release in deciding a motion. Moreover, Assured's acknowledgment that it would conduct an independent assessment does not facially contradict Assured's claim that Assured was defrauded in relying on the data and documents provided by RBS. The scope of the independent assessment that Assured agreed to undertake is also not clear. Thus, even if the Court were to consider the release, the Court must draw all factual

inferences in favor of the plaintiff and cannot conclude at this stage the release precludes Assured from pleading reasonable reliance.

The defendants next argue that Assured cannot plead reasonable reliance because Assured possessed the same Clayton due diligence that RBS had, and that allegedly put RBS on notice of the defects in the mortgage loans. However, the plaintiff does not allege that the Clayton due diligence was the source of information giving rise to RBS's knowledge, but alleges that the due diligence was evidence of RBS's knowledge. Amended complaint paragraph 87. The plaintiff alleges that RBS routinely overrode the due diligence designation by due diligence firms, such as Clayton. Amended complaint paragraphs 87 to 91. Thus, without a factual record, the Court cannot determine at this stage that Clayton due diligence rendered Assured's reliance upon reasonable as a matter of law.

The defendants then argue that Assured had access to the loan files and should have made its own inquiry. However, even though Assured eventually did obtain access to the loan files through the beneficial owner of the certificates, it is not clear from the face of the amended complaint that Assured had such access before the policy was issued. Amended complaint paragraph 72. Moreover, even if Assured had such access prior to issuing the policy the Court also cannot determine at this stage that Assured's reliance on materials

provided by RBS was unreasonable as a matter of law. In light of factors such as the industry's general practice, the amount of work required to conduct independent assessment and the time frame within which Assured was requested to issue the policy. *See CIFG Assurance North America Inc. v. Goldman, Sachs & Company, 966 N.Y.S.2d 369, 371 (App. Div. 2013)*.

Finally, the defendants argue that reasonable reliance is precluded by the disclosures made in the term sheet and prospectus supplement. In particular, the prospectus supplement discloses the risks associated with the investment, based on loans made to low credit quality borrowers, the possibility that a borrower made present fraudulent documentation and obtaining the loan, and the market conditions that made the investment risky. See Hail declaration Exhibit C, prospectus at 13 to 14, 31 to 33 and 48. However, these disclosures address the inherent risks of the investments and are insufficient to refute allegations that RBS knowingly misrepresented the quality of the loans and the originator's adherence to the underwriting guidelines for the specific loans, included in the Soundview transaction.

Similarly, the defendants rely on the disclosure in the prospectus supplement that "a substantial number of the mortgage loans to be included in the trust will represent exceptions" to WMC's underwriting guidelines. Hail Declaration Exhibit C at S87. Arguably that this, along with other

factors, should have put Assured on notice regarding the alleged fraud.

However, the defendants reliance on this language is out of context. Immediately before the language quoted by RBS, the prospectus supplement reads "The mortgage loans have been either, one, originated generally in accordance with the underwriting guideline established by WMC, or two, purchased generally after reunderwriting, generally in accordance with the underwriting guidelines. On a case by case basis WMC may determine that based upon compensating factors, a prospective mortgager not strictly qualifying warrants an underwriting exception." Hail declaration Exhibit C at S86. Thus, the disclosure that some mortgagers were granted exceptions in good faith after case-by-case evaluations of compensating factors, does not render unreasonable Assured's reliance on the data in the loan tape and the representations regarding WMC's general adherence to the underwriting guidelines.

Therefore, based on the facts of the alleged amended complaint, and on the documents allegedly relied upon, the Court cannot determine that Assured's reliance was unreasonable as a matter of law. Because the plaintiff has pleaded a fraud claim based on misrepresentations, it is unnecessary for the Court to reach the question of whether the plaintiff had sufficiently pleaded fraud based on concealment. The defendant's motion to dismiss the fraud claim Count One is,

therefore, denied.

The plaintiff also brings a claim against all defendants for aiding and abetting fraud. The defendants move in a footnote to dismiss this claim on two grounds at 24 note 57. First, the defendants argue that the fraud claim should be dismissed and the aiding and abetting claim is not sustainable without an underlying fraud claim. This argument is moot because the Court has denied defendant's motion to dismiss the fraud claim. The defendants also argue the aiding and abetting claim is duplicative because each of the defendants is accused of committing the underlying fraud. However, at this stage in the litigation, the specific role of each defendant is unclear and the absence of any factual evidence aiding and abetting fraud remains an appropriate cause of action to join all defendants so as to hold them responsible for each other's actions in furtherance of the fraud. *See Bobash, Inc. v. Festinger, No. 03909/05, 2007 WL 969435, at *4 (N.Y. Sup. Ct. 2007*). Accordingly, the defendant's motion to dismiss the claims for aiding and abetting fraud is denied.

Finally, the defendant moves to dismiss the plaintiff's claim under New York insurance law section 3105 arguing that the plaintiff does not seek rescission and, therefore, is not entitled to rescissory damages. Section 3105 provides that, "No misrepresentation shall avoid any contract of insurance or defeat recovery thereunder, unless such

misrepresentation was mater." New York insurance law section 3105(b)(1). Parties in this case do not dispute the availability of rescissory damages as a remedy for a violation of Section 3105. See *MBIA Insurance Corp. v. Countrywide Home Loans, 936 N.Y.S.2d 513, 523 (Sup. Ct. 2012)*, modified on other grounds, *963, N.Y.S.2d. 21 (App. Div. 2013); Syncora Guarantee Inc. v. Countrywide Home Loans, Inc. 935 N.Y.S.2d 858, 869-70 (Sup. Ct. 2012*). New York courts have adopted the rationale behind the rescissory damages articulated by Delaware courts. See, for example, *MBIA 936 N.Y.S.2d at 523; Syncora, 935 N.Y.S.2d at 869-70.* As the Delaware Court of Chancery has explained: "Rescissory damages are an exception to the normal out-of-pocket measure. Because such damages are measured as of a point in time after the transaction, whereas compensatory damages are determined at the time of the transaction. As a consequence, rescissory damages may be significantly higher than the conventional out-of-pocket damages because rescissory damages could include post-transaction incremental value elements that would not be captured in an out-of-pocket recovery." *Strassburger v. Earley, 752 A.2d 557, 579 (Del. Ch. 2000*).

In this case, Assured seeks recovery for "all payments Assured has made and will make pursuant to the policy without resort to rescission." Amended complaint paragraph 120. (Emphasize added).

Therefore, what Assured seeks in the Section 3105 claim is, in fact, forward-looking rescissory damages, not backward-looking compensatory damages, of payments it has already made.

Assured attempts to plead a claim for what are rescissory damages, while explicitly declining to seek rescission. Indeed, Assured stated at the oral argument that it would be prohibited from seeking rescission under the terms of its insurance contract, and does not seek rescission in the complaint. Assured relies on the appellate division's decision in *MBIA Insurance Corp. v. Countrywide Home loans, 963 N.Y.S.2d 21 (App. Div. 2013)*, in which the Court held that the statutory language of Section 3105 can mean to allow "recovery of payments made pursuant to an insurance policy without resort to rescission." Id. at 22. That language, at most, can be read to support the proposition that Section 3105 allows recovery of rescissory damages. However, such damages are available only where rescission is warranted, but "impractical." *Syncora 935 N.Y.S.2d at 870*. The appellate division in *MBIA* held in the paragraph immediately following the language quoted by Assured, that rescission is not warranted where "a plaintiff voluntarily give up the right to seek rescission," or whether the plaintiff "does not actually seek rescission." *MBIA* 963 N.Y.S.2d at 22.

The appellate division made clear that a plaintiff should not be permitted to use the very rarely used equitable

tool "to reclaim a right it voluntarily contracted away or to obtain relief it never actually requested." Id.

Moreover, in circumstances, very similar to those in this case, the appellate division made it clear that rescission was not impracticable. "Impracticability refers to a scenario in which rescission is impracticable or impossible because the subject of the contracts sought to be rescinded no longer exists or is otherwise impossible or impracticable to recover. Here, rescission is not impracticable in any relevant sense, rather, it is legally unavailable," Id.

Assured attempts to distinguish the appellate's division's decision in *MBIA*, which rejected the availability of rescissory damages in circumstance very similar to this case. Assured argues that it is seeking compensatory damages rather than rescissory damages, but the damages it seeks are, in fact, the kind of forward-looking damages that are rescissory damages and that the appellate division rejected in *MBIA*. It seeks to avoid the forward-looking consequences of its insurance policy without actually rescinding the policy, which it concedes it is unable to do in the terms of the policy and has not sought in the complaint.

Moreover, Assured made no argument that rescission is impracticable, and that rescissory damages is an appropriate remedy. Those arguments would be contrary to the appellate division's decision in *MBIA*. Therefore, Assured presents no

argument that rescission is both warranted and impractical to justify awarding rescissory damages. Accordingly, Assured has failed to state a claim for rescissory damages and the defendant's motion to dismiss the claim for rescissory damages and, indeed, the claim under the insurance law is granted.

The Court has considered all of the arguments raised by the parties to the extent not specifically addressed, the apartments are either moot or without merit for the foregoing reason, the defendant's motion to dismiss is denied, in part, and granted, in part. The clerk is directed to close docket number 17. So ordered.

Therefore, it's time to have a scheduling order. Time to answer, defendant's time to answer is April 4.

How much time for discovery?

MR. HAIL: I'm going to look for discovery first on the subject matter of the release and bifurcating. I would anticipate a 12(c) motion or something similar in the short term, about the nature of the diligence and the reliance they have on it. I would think that we ought to set up first discovery on that issue and then merits discovery after we had an opportunity to be heard on what the diligence says and the role it played on the release issues.

MR. MAHER: Your Honor, we waited a long time to commence discovery in this case. We would like to commence merits discovery on all issues so we can bring all issues to

the Court-attention as soon as possible. In terms of the timing, I haven't consulted with counsel in terms of how much time they think they would need.

MR. HAIL: We will good for one month on the reliance.

MR. MAHER: We will need at least six months in terms of discovery. There will be lot of document production and other issue that need to be revolved.

MR. HAIL: That's exactly what we are trying to avoid on the release issue.

THE COURT: I have already expressed some doubts with respect to whether the release is the end of the litigation pass and the difficulty of deciding that on a 12(c) motion. You say maybe you will make a motion for summary judgment. Well, that implies that you introduce affidavits of what was produced, what was relied on. Inevitably, I would think, that a motion like that would rely on what did the Assured people know, what do the Assured people say that relied on, and you are going to be looking for depositions of the Assured people.

MR. HAIL: That was my suggestion, your Honor. We do a 12(c) motion, set that up front and consider that. Or we could bifurcate the discovery.

THE COURT: I don't want depositions to have to be taken twice of the same people. If you say we will take the depositions of the Assured's people within the next month without getting all of the documents and we won't take them

again, that's one thing, I will listen to that. If you say, they don't need our depositions, but we are going to take their depositions and we will take them again -- here is what I will do. The defendant's time to answer is April 4. I will have a Rule 16 conference after you have had your Rule 26(f) conference, and after you have had your Rule 26 conference and you have given me your Rule 26(f) report. The answer is due on April 4 and I will have a conference on April 8 at 4:30 p.m.

MR. HAIL: Your Honor, I hate to ask, but can we move it slightly off that. The 8th and 9th I'm not in town.

THE COURT: Could you do it on April 7?

MR. MAHER: I think so. Is that the Monday?

THE COURT: I can do it April 10.

MR. HAIL: I rather do it on the 7th, if at all possible. The morning would be getter for me.

THE COURT: I don't know what I will be.

MR. HAIL: I will make it work on the 7th.

THE COURT: April 7, 4:30 and you should get me your Rule 26(f) March 28. In telling me what you want to do with the case, you have to ask the questions about who is going to be deposed and are they going to be deposed more than once and what is schedule is going to be with respect to the production of documents on both sides, and what you are going to do about whether there are any BSI issues in the case. You have to go through that checklist for BSI for a complex case. Maybe there

won't be many disputes in this case. Plaintiff says six months to complete all discovery. This is just between individuals. It's not a classism. It's not a collective. Individual plaintiff. The amount of discovery is relatively cabined.

MR. HAIL: It seems like every case starts off that way, that discovery ought to be relatively discreet and complete.

THE COURT: We will try and keep it that way.

MR. HAIL: I'm all in favor of that. But often it doesn't work out that way. I don't know if it's six months or not. I have to talk to my client. I will work with Mr. Maher.

MR. MAHER: I agree with that. We want to work with opposing counsel to come up with something reasonable.

What I said, your Honor, was at least six months. But I actually need to confer with my client in term of what's needed. I think the schedule you set where are conference report is due in 11 days is aggressive. I'm out the latter part for that week. I'm out three or four days before the 28th. I would ask for a little more time so we can confer and come up with some reasonable proposal for you in terms of what might work in this case. I subject pushing those dates back maybe a week.

THE COURT: Fine.

I'm happy to do that. I want to be productive. We will do the conference on April 15 at 4:30. You can get me

your 26(f) reports by April 8.

MR. MAHER: Very well, your Honor.

THE COURT: Both sides can make this case an example of efficient discovery. Both sides have an interest in doing that. Good to see you all.

(Adjourned)